

## Program Summary

### Sources of K-12 Capital Funding

#### **Program Overview**

Arizona school districts receive capital funding to maintain and renovate existing facilities and to purchase new land, facilities, and equipment. The responsibility for financing capital costs is shared by the state, counties, and school districts.

Several mechanisms for providing capital funding are established in statute. A description of each funding mechanism is included in the Program Funding section below. *Table 3* summarizes the recent history of capital funding.

#### **Program Funding**

Capital funding is administered by 3 government entities:

- The Arizona Department of Education
- The Arizona School Facilities Board
- Local school districts

##### *Arizona Department of Education*

The Arizona Department of Education (ADE) allocates Capital Outlay Revenue Limit (CORL) and Soft Capital funding as part of the K-12 equalization funding formula. The total amount of funding provided to each school district for each of these items is based on student enrollment in the district.

CORL funds can be used to maintain and renovate facilities, purchase capital items, or construct school buildings and purchase or lease land. In FY 2006, JLBC Staff estimates that \$231.0 million in CORL funding will be provided through the K-12 equalization funding formula. This is an increase of \$5.2 million (2.3%) over FY 2005. The additional funding is due to student enrollment growth.

Statute allows school districts to transfer CORL funding to the Maintenance and Operations (M&O) portion of their budgets. (M&O monies are generally used to pay for on-going operating, rather than capital, costs.) Statewide school districts annually transfer about 75% of CORL funds to M&O. In FY 2006 this would amount to approximately \$175 million.

Soft Capital funds can only be used to purchase short-term capital items, including technology, textbooks, library resources, instructional aids, pupil transportation vehicles, furniture and equipment. Soft Capital funds may not be used for maintenance and operation expenses. In FY 2006, JLBC Staff estimates \$196.4 million in Soft Capital will be provided through the K-12 equalization funding formula. This is an increase of \$2.5 million (1.3%)

over FY 2005. The additional funding is due to student enrollment growth.

As with all K-12 equalization formula funding, formula funding for CORL and Soft Capital is generated from 3 sources: the State General Fund, county property tax levies, and school district property tax levies. Of the total FY 2006 equalization funding that will be distributed to districts statewide, JLBC Staff estimates the state will contribute 56.5%, county property tax levies will contribute 5.0%, and school district property tax levies will contribute 38.5%.

##### *School Facilities Board*

The Arizona School Facilities Board (SFB) distributes Deficiencies Correction, Building Renewal, and New School Facilities funding.

The Deficiencies Correction Program was designed to provide school districts with one-time funding to correct any existing facility deficiencies and bring all schools in the state into compliance with a set of minimum facility guidelines adopted by SFB in 1999. These guidelines include both space and quality standards for school buildings.

The state has provided funding to each district based on an assessment of its facilities conducted by SFB. Over the course of the program, the state has distributed a total of \$1.3 billion. Funding has been provided from the following state sources: the State General Fund, Proposition 301 Sales Tax Bond Proceeds, State Land Trust Bond Proceeds, Qualified Zone Academy Bond (QZAB) Proceeds, and Other Fund Transfers. *Table 1* displays total Deficiencies Correction funding by fund source.

<b>Table 1</b>	
<b>Deficiencies Correction Funding</b>	
<b><u>Funding Source</u></b>	<b><u>Total Funding</u></b>
General Fund	\$ 176,000,000
Sales Tax Bond Proceeds	832,865,000
Land Trust Bond Proceeds	247,135,000
QZAB Proceeds	20,000,000
Other Fund Transfers	38,000,000
<b>TOTAL</b>	<b>\$1,314,000,000</b>

Once SFB has completed the Deficiencies Correction Program and brought all school districts into compliance with the minimum facility guidelines, the Building Renewal Program is designed to provide districts with funding to maintain their facilities at the minimum guidelines. Specifically, districts may use Building Renewal monies to fund: 1) Major repairs and renovations; 2) System upgrades to maintain or

extend the useful life of a building; 3) Infrastructure costs; and 4) Portable and modular building placement or relocation. A district may also allocate up to 8% of Building Renewal funding for preventative maintenance.

Building Renewal funding is allocated on a building-by-building basis, taking into account each building's age, square footage, and prior renovations. Funding is provided from the State General Fund. In FY 2006 the program is funded at \$70 million. This amount is unchanged from FY 2005.

The New School Facilities Program provides districts with funding to purchase land and construct facilities to accommodate student growth. Funding is allocated based on a comparison of existing district square footage and student enrollment projections. Initially the program was funded from the State General Fund on a pay-as-you-go basis. From FY 2003 through FY 2005, however, the state borrowed money to fund the program. In FY 2006, the state returned to a cash basis, funding the program at \$250 million. This is equal to the amount that was provided through debt financing in FY 2005.

#### *Local School Districts*

Local school districts have several options for supplementing state capital funding. These include Capital Overrides, Class B Bonds, Impact Aid Revenue Bonds, Lease-Purchase Proceeds, Adjacent Ways Funds, and Desegregation Funds.

Capital Overrides provide districts with a mechanism for receiving additional capital funding beyond the amounts distributed to them through the K-12 equalization funding formula. The additional funding, which must be approved by a majority of voters in the school district, is generated from an increase in the local secondary property tax rate.

Class B Bond proceeds can be used to purchase land and school buildings, construct and renovate facilities, lease school sites, improve school grounds, or purchase pupil transportation vehicles. Class B Bond proceeds may not be used for short-term capital items. Voters must approve the issuance of bonds, which are paid back through an increase in the local secondary property tax rate.

Impact Aid Revenue Bond proceeds can be used for the same purposes as Class B Bond proceeds; however, Impact Aid Revenue Bonds can only be issued by districts that receive federal Impact Aid. The federal government distributes Impact Aid to school districts that have a reduced property tax base because of a federal military base or Indian reservation. Voters must approve the issuance of

these bonds, which are paid back with on-going Impact Aid revenues.

Lease-Purchase proceeds can be used to finance school buildings or land. The term of the Lease-Purchase agreement must be less than 5 years. The agreement is subject to voter approval if proceeds from the agreement will be used for school buildings. Otherwise, the local school district governing board must approve the agreement.

Adjacent Ways funding can be used to construct, maintain, or improve any public way that is adjacent to school land. This would include sidewalks, sewers, utility lines, and roadways. The additional funding, which must be approved by the local school district governing board, is generated from an increase in the local primary property tax rate.

Desegregation funding is intended to provide school districts with a mechanism for complying with a court order of desegregation or an administrative agreement with the U.S. Department of Education Office of Civil Rights to remediate alleged or proven racial discrimination. The additional funding, which must be approved by the local school district governing board, is generated from an increase in the local primary property tax rate.

Districts may designate a portion of Desegregation funds for capital in their budgets. Currently, about \$15 million of the approximately \$200 million in Desegregation funding is allocated for capital expenditures.

#### *Charter Schools*

Charter schools do not receive a specific allocation of state funds for capital purposes. Instead their state formula funding consists of "Base Support Level" and "Additional Assistance" amounts, both of which are unrestricted.

The statutory minimum facility guidelines that govern district schools do not apply to charter schools. Charter schools do receive funding from SFB.

Charter schools can apply to the U.S. Department of Education for a grant to construct, acquire, lease, or renovate facilities. In addition, charter schools can apply to an Industrial Development Authority (IDA) to issue bonds on their behalf. An IDA is a political subdivision with the authority to issue tax-exempt bonds on behalf of a government entity.

#### **Recent Programmatic Changes**

The Legislature made the following capital financing related changes during the past legislative session:

- Allow school districts to use New School Facilities funds for project management or preconstruction services;
- Require the Legislature to appropriate Building Renewal and New School Facilities funding.

### **Performance Measures**

Table 2 displays some of the key performance measures SFB collects. Many of these measures actually provide an assessment of district activities, rather than the performance of SFB. These would include the measures assessing percent of school districts meeting the minimum adequacy standards, percent of schools determined to have an adequate preventative maintenance program, and number of new school construction projects completed.

It is difficult to develop a set of performance measures that assess the performance of SFB, as the main function of the agency is to distribute funding to school districts. The effectiveness and efficiency with which capital funds are spent depends largely on the ability of school districts to administer those funds.

Like SFB, ADE is only responsible for the distribution of capital funding. The agency, therefore, does not collect capital related performance measures.

<b>Table 2</b>			
<b>School Facilities Board Performance Measures</b>			
<b><u>Performance Measure</u></b>	<b><u>FY 2004 Actual</u></b>	<b><u>FY 2006 Estimate</u></b>	
Percent of school districts inspected meeting minimum adequacy standards	99	100	
Percent of inspected schools determined to have an adequate preventative maintenance program	0	77	
Number of new school construction projects completed	40	50	
Percent of all school districts rating the Board's services as "good" or "excellent" in annual survey	80	90	

<b>Table 3</b>				
<b>K-12 Capital Funding History</b>				
(\$ in millions)				
<b><u>Funding Source</u></b>	<b><u>FY 2002</u></b>	<b><u>FY 2003</u></b>	<b><u>FY 2004</u></b>	<b><u>FY 2005</u></b>
CORL <sup>1/</sup>	\$ 209.5	\$ 214.9	\$ 221.9	\$ 225.8
Soft Capital <sup>1/</sup>	181.3	185.1	190.0	193.9
Deficiencies Correction <sup>2/</sup>	444.0	270.7	247.2	100.0
Building Renewal <sup>3/</sup>	62.1	38.3	0.0	70.0
New School Facilities <sup>3/</sup>	166.8	400.0	250.0	250.0
Capital Overrides <sup>4/</sup>	44.2	48.9	N/A	N/A
Class B Bonds <sup>5/ 6/</sup>	116.1	175.8	230.8	N/A
Impact Aid Revenue Bonds <sup>5/</sup>	13.1	9.1	25.6	N/A
Lease-Purchase <sup>5/</sup>	2.8	9.0	12.1	N/A
Adjacent Ways <sup>7/</sup>	20.7	22.5	30.3	N/A
Desegregation <sup>4/</sup>	13.3	15.6	N/A	N/A
<b>TOTAL</b>	<b>\$ 1,273.9</b>	<b>\$ 1,389.9</b>	<b>N/A</b>	<b>N/A</b>

<sup>1/</sup> From ADE Basic State Aid Payment (apportionment) data file.  
<sup>2/</sup> From SFB August 2005 board meeting information.  
<sup>3/</sup> From JLBC Appropriations Report.  
<sup>4/</sup> From ADE "Outside the Revenue Control Limit" data file.  
<sup>5/</sup> From the Department of Revenue Report of Indebtedness.  
<sup>6/</sup> Excludes refunded bonds.  
<sup>7/</sup> From ADE Annual Report.